Exhibit L

CCH
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Accounting Research Manager ® - Audit Public

FASB - Financial Accounting Standards Board
Accounting Research Bulletins (ARB)\Original Pronouncements (As Amended)
43: Restatement and Revision of Accounting Research Bulletins
Chapter 1: Prior Opinions

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Section A — Rules Adopted by Membership

Below are reprinted the six rules adopted by the membership of the Institute in 1934, the first five of which had been recommended in 1933 to the New York Stock Exchange by the Institute's committee on cooperation with stock exchanges.

1. Unrealized profit should not be credited to income account of the corporation either directly or indirectly, through the medium of charging against such unrealized profits amounts which would ordinarily fall to be charged against income account. Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured. In the absence of the circumstances referred to above or other specific guidance, such as in FASB Statement No. 66, *Accounting for Sales of Real Estate*, the installment method is not acceptable. An exception to the general rule may be made in respect of inventories in industries (such as packing-house industry) in which owing to the impossibility of determining costs it is a trade custom to take inventories at net selling prices, which may exceed cost.

2. Capital surplus, however created, should not be used to relieve the income account of the current or future years of charges which would otherwise fall to be made thereagainst. This rule might be subject to the exception that where, upon reorganization, a reorganized company would be relieved of charges which would require to be made against income if the existing corporation were continued, it might be regarded as permissible to accomplish the same result without reorganization provided the facts were as fully revealed to and the action as formally approved by the shareholders as in reorganization.

3. Earned surplus of a subsidiary company created prior to acquisition does not form a part of the consolidated earned surplus of the parent company and subsidiaries; nor can any dividend declared out of such surplus properly be credited to the income account of the parent company.

4. [This paragraph has been deleted. See Status page.]

5. Notes or accounts receivable due from officers, employees, or affiliated companies must be shown separately and not included under a general heading such as notes receivable or accounts receivable.

6. If capital stock is issued nominally for the acquisition of property and it appears that at about the same time, and pursuant to a previous agreement or understanding, some portion of the stock so issued is donated to the corporation, it is not permissible to treat the par value of the stock nominally issued for the property as the cost of that property. If stock so donated is subsequently sold, it is not permissible to treat the proceeds as a credit to surplus of the corporation.

Section B — Opinion Issued by Predecessor Committee

1. Following an inquiry made by the New York Stock Exchange, a predecessor committee on accounting procedure in 1938 issued the following report:

"Profits or Losses on Treasury Stock"

2. "The executive committee of the American Institute of Accountants has directed that the following report of the committee on accounting procedure, which it received at a meeting on April 8, 1938, be published, without approval or disapproval of the committee, for the information of members of the Institute:

To the Executive Committee,
American Institute of Accountants:

3. "This committee has had under consideration the question regarding treatment of purchase and sale by a corporation of its own stock, which was raised during 1937 by the New York Stock Exchange with the Institute's special committee on cooperation with stock exchanges.

4. "As a result of discussions which then took place, the special committee on cooperation with stock exchanges made a report which was approved by the committee on accounting procedure and the executive committee, and a copy of which was furnished to the committee on stock list of the New York Stock Exchange. The question raised was stated in the following form:

5. "'Should the difference between the purchase and resale prices of a corporation's own common stock be reflected in earned surplus (either directly or through inclusion in the income account) or should such difference be reflected in capital surplus?'

6. "The opinion of the special committee on cooperation with stock exchanges reads in part as follows:

7. "'Apparently there is general agreement that the difference between the purchase price and the stated value of a corporation's common stock purchased and retired should be reflected in capital surplus. Your committee believes that while the net asset value of the shares of common stock outstanding in the hands of the public may be increased or decreased by such purchase and retirement, such transactions relate to the capital of the corporation and do not give rise to corporate profits or losses. Your committee can see no essential difference between (a) the purchase and retirement of a corporation's own common stock and the subsequent issue of common shares, and (b) the purchase and resale of its own common stock.'

a. When a corporation's stock is retired, or purchased for constructive retirement (with or without an intention to retire the stock formally in accordance with applicable laws):

i. *an excess of purchase price over par or stated value* may be allocated between capital surplus and retained earnings. The portion of the excess allocated to capital surplus should be limited to the sum of (a) all capital surplus arising from previous retirements and net "gains" on sales of treasury stock of the same issue and (b) the prorata portion of capital surplus paid in, voluntary transfers of retained earnings, capitalization of stock dividends, etc., on the same issue. For this purpose, any remaining capital surplus applicable to issues fully retired (formal or constructive) is deemed to be applicable prorata to shares of

common stock. Alternatively, the excess may be charged entirely to retained earnings in recognition of the fact that a corporation can always capitalize or allocate retained earnings for such purposes.

ii. *an excess of par or stated value over purchase price* should be credited to capital surplus.

b. When a corporation's stock is acquired for purposes other than retirement (formal or constructive), or when ultimate disposition has not yet been decided, the cost of acquired stock may be shown separately as a deduction from the total of capital stock, capital surplus, and retained earnings, or may be accorded the accounting treatment appropriate for retired stock. "Gains" on sales of treasury stock not previously accounted for as constructively retired should be credited to capital surplus; "losses" may be charged to capital surplus to the extent that previous net "gains" from sales or retirements of the same class of stock are included therein, otherwise to retained earnings.

c. [This subparagraph has been deleted. See Status page.]

8. "This committee is in agreement with the views thus expressed; it is aware that such transactions have been held to give rise to taxable income, but it does not feel that such decisions constitute any bar to the application of correct accounting procedure as above outlined.

9. "The special committee on cooperation with stock exchanges continued and concluded its report with the following statement:

10. "'Accordingly, although your committee recognizes that there may be cases where the transactions involved are so inconsequential as to be immaterial, it does not believe that, as a broad general principle, such transactions should be reflected in earned surplus (either directly or through inclusion in the income account).'

11. "This committee agrees with the special committee on cooperation with stock exchanges, but thinks it desirable to point out that the qualification should not be applied to any transaction which, although in itself inconsiderable in amount, is a part of a series of transactions which in the aggregate are of substantial importance.

11A. Laws of some states govern the circumstances under which a corporation may acquire its own stock and prescribe the accounting treatment therefore. Where such requirements are at variance with paragraph 7, the accounting should conform to the applicable law. When state laws relating to acquisition of stock restrict the availability of retained earnings for payment of dividends or have other effects of a significant nature, these facts should be disclosed.

12. "This committee recommends that the views expressed be circulated for the information of members of the Institute."

Chapter 2: Form of Statements

Section A—Comparative Financial Statements

1. The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes

affecting the enterprise. Such presentation emphasizes the fact that statements for a series of periods are far more significant than those for a single period and that the accounts for one period are but an instalment of what is essentially a continuous history.

2. In any one year it is ordinarily desirable that the balance sheet, the income statement, and the surplus statement be given for one or more preceding years as well as for the current year. Footnotes, explanations, and accountants' qualifications which appeared on the statements for the preceding years should be repeated, or at least referred to, in the comparative statements to the extent that they continue to be of significance. If, because of reclassifications or for other reasons, changes have occurred in the manner of or basis for presenting corresponding items for two or more periods, information should be furnished which will explain the change. This procedure is in conformity with the well recognized principle that any change in practice which affects comparability should be disclosed.

3. It is necessary that prior-year figures shown for comparative purposes be in fact comparable with those shown for the most recent period, or that any exceptions to comparability be clearly brought out as described in FASB Statement No. 154, *Accounting Changes and Error Corrections*.

4. Circumstances vary so greatly that it is not practicable to deal here specifically with all situations. The independent accountant should, however, make very clear what statements are included within the scope of his report.

Section B—Combined Statement of Income and Earned Surplus

[Section B has been deleted. See Status page.]

Chapter 3: Working Capital

Section A — Current Assets and Current Liabilities

1. The working capital of a borrower has always been of prime interest to grantors of credit; and bond indentures, credit agreements, and preferred stock agreements commonly contain provisions restricting corporate actions which would effect a reduction or impairment of working capital. Many such contracts forego precise or uniform definitions and merely provide that current assets and current liabilities shall be determined in accordance with generally accepted accounting principles. Considerable variation and inconsistency exist, however, with respect to their classification and display in financial statements. In this section the committee discusses the nature of current assets and current liabilities with a view toward a more useful presentation thereof in financial statements.

2. The committee believes that, in the past, definitions of current assets have tended to be overly concerned with whether the assets may be immediately realizable. The discussion which follows takes cognizance of the tendency for creditors to rely more upon the ability of debtors to pay their obligations out of the proceeds of current operations and less upon the debtor's ability to pay in case of liquidation. It should be emphasized that financial statements of a going concern are prepared on the assumption that the company will continue in business. Accordingly, the views expressed in this section represent a departure from any narrow definition or strict one year interpretation of either current assets or current liabilities; the objective is to relate the criteria developed to the operating cycle of a business.

3. Financial position, as it is reflected by the records and accounts from which the statement is prepared, is revealed in a presentation of the assets and liabilities of the enterprise. In the statements of

manufacturing, trading, and service enterprises these assets and liabilities are generally classified and segregated; if they are classified logically, summations or totals of the *current* or *circulating* or *working* assets, hereinafter referred to as *current assets*, and of obligations currently payable, designated as *current liabilities*, will permit the ready determination of working capital. *Working capital*, sometimes called *net working capital*, is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total enterprise capital which constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business. If the conventions of accounting relative to the identification and presentation of current assets and current liabilities are made logical and consistent, the amounts, bases of valuations, and composition of such assets and liabilities and their relation to the total assets or capital employed will provide valuable data for credit and management purposes and afford a sound basis for comparisons from year to year. It is recognized that there may be exceptions, in special cases, to certain of the inclusions and exclusions as set forth in this section. When such exceptions occur they should be accorded the treatment merited in the particular circumstances under the general principles outlined herein.

4. For accounting purposes, the term *current assets* is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. Thus the term comprehends in general such resources as (a) cash available for current operations and items which are the equivalent of cash; (b) inventories of merchandise, raw materials, goods in process, finished goods, operating supplies, and ordinary maintenance material and parts; (c) trade accounts, notes, and acceptances receivable; (d) receivables from officers, employees, affiliates, and others, if collectible in the ordinary course of business within a year; (e) instalment or deferred accounts and notes receivable if they conform generally to normal trade practices and terms within the business; (f) marketable securities representing the investment of cash available for current operations, including investments in debt and equity securities classified as trading securities under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*; and (g) prepaid expenses such as insurance, interest, rents, taxes, unused royalties, current paid advertising service not yet received, and operating supplies. Prepaid expenses are not current assets in the sense that they will be converted into cash but in the sense that, if not paid in advance, they would require the use of current assets during the operating cycle. An asset representing the overfunded status of a single-employer defined benefit postretirement plan shall be classified pursuant to FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

5. The ordinary operations of a business involve a circulation of capital within the current asset group. Cash is expended for materials, finished parts, operating supplies, labor, and other factory services, and such expenditures are accumulated as inventory cost. Inventory costs, upon sale of the products to which such costs attach, are converted into trade receivables and ultimately into cash again. The average time intervening between the acquisition of materials or services entering this process and the final cash realization constitutes an *operating cycle*. A one-year time period is to be used as a basis for the segregation of current assets in cases where there are several operating cycles occurring within a year. However, where the period of the operating cycle is more than twelve months, as in, for instance, the tobacco, distillery, and lumber businesses, the longer period should be used. Where a particular business has no clearly defined operating cycle, the one-year rule should govern.

6. This concept of the nature of current assets contemplates the exclusion from that classification of such resources as: (a) cash and claims to cash which are restricted as to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets, or are segregated[1] for the liquidation of long-term debts; (b) investments in securities (whether marketable or not) or advances which have been made for the purposes of control, affiliation, or other

continuing business advantage; (c) receivables arising from unusual transactions (such as the sale of capital assets, or loans or advances to affiliates, officers, or employees) which are not expected to be collected within twelve months; (d) cash surrender value of life insurance policies; (e) land and other natural resources; (f) depreciable assets; and (g) long-term prepayments which are fairly chargeable to the operations of several years, or deferred charges such as bonus payments under a long-term lease, costs of rearrangement of factory layout or removal to a new location.

[1] Even though not actually set aside in special accounts, funds that are clearly to be used in the near future for the liquidation of long-term debts, payments to sinking funds, or for similar purposes should also, under this concept, be excluded from current assets. However, where such funds are considered to offset maturing debt which has properly been set up as a current liability, they may be included within the current asset classification.

7. The term *current liabilities* is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. As a balance-sheet category, the classification is intended to include obligations for items which have entered into the operating cycle, such as payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of services;[2] and debts which arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes. Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually twelve months, are also intended for inclusion, such as short-term debts arising from the acquisition of capital assets, serial maturities of long-term obligations, amounts required to be expended within one year under sinking fund provisions, and agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons.[3] The current liability classification is also intended to include obligations that, by their terms, are due on demand or will be due on demand within one year (or operating cycle, if longer) from the balance sheet date, even though liquidation may not be expected within that period. It is also intended to include long-term obligations that are or will be callable by the creditor either because the debtor's violation of a provision of the debt agreement at the balance sheet date makes the obligation callable or because the violation, if not cured within a specified grace period, will make the obligation callable. Accordingly, such callable obligations shall be classified as current liabilities unless one of the following conditions is met:

[2] Examples of such current liabilities are obligations resulting from advance collections on ticket sales, which will normally be liquidated in the ordinary course of business by the delivery of services. On the contrary, obligations representing long-term deferments of the delivery of goods or services would not be shown as current liabilities. Examples of the latter are the issuance of a long-term warranty or the advance receipt by a lessor of rental for the final period of a ten-year lease as a condition to execution of the lease agreement.

[3] Loans accompanied by pledge of life insurance policies would be classified as current liabilities when, by their terms or by intent, they are to be repaid within twelve months. The pledging of life insurance policies does not affect the classification of the asset any more than does the pledging of receivables, inventories, real estate, or other assets as collateral for a short-term loan. However, when a loan on a life insurance policy is obtained from the insurance company with the intent that it will not be paid but will be liquidated by deduction from the proceeds of the policy upon maturity or cancellation, the

obligation should be excluded from current liabilities.

a. The creditor has waived[3a] or subsequently lost[3b] the right to demand repayment for more than one year (or operating cycle, if longer) from the balance sheet date.

[3a] If the obligation is callable because of violations of certain provisions of the debt agreement, the creditor needs to waive its right with regard only to those violations.

[3b] For example, the debtor has cured the violation after the balance sheet date and the obligation is not callable at the time the financial statements are issued.

b. For long-term obligations containing a grace period within which the debtor may cure the violation, it is probable[3c] that the violation will be cured within that period, thus preventing the obligation from becoming callable.

[3c] *Probable* is defined in FASB Statement No. 5, *Accounting for Contingencies*, as "likely to occur" and is used in the same sense in this paragraph.

If an obligation under (b) above is classified as a long-term liability (or, in the case of an unclassified balance sheet, is included as a long-term liability in the disclosure of debt maturities), the circumstances shall be disclosed. Short-term obligations that are expected to be refinanced on a long-term basis, including those callable obligations discussed herein, shall be classified in accordance with FASB Statement No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced*. A liability representing the underfunded status of a single-employer defined benefit postretirement plan shall be classified pursuant to Statement 158.

8. This concept of current liabilities would include estimated or accrued amounts which are expected to be required to cover expenditures within the year for known obligations (a) the amount of which can be determined only approximately (as in the case of provisions for accruing bonus payments) or (b) where the specific person or persons to whom payment will be made cannot as yet be designated (as in the case of estimated costs to be incurred in connection with guaranteed servicing or repair of products already sold). The current liability classification, however, is not intended to include debts to be liquidated by funds which have been accumulated in accounts of a type not properly classified as current assets, or long-term obligations incurred to provide increased amounts of working capital for long periods. When the amounts of the periodic payments of an obligation are, by contract, measured by current transactions, as for example by rents or revenues received in the case of equipment trust certificates or by the depletion of natural resources in the case of property obligations, the portion of the total obligation to be included as a current liability should be that representing the amount accrued at the balance-sheet date.

[4] [This footnote has been deleted. See Status page.]

9. The amounts at which various current assets are carried do not always represent their present realizable cash values. Accounts receivable net of allowances for uncollectible accounts, and for unearned discounts where unearned discounts are considered, are effectively stated at the amount of cash estimated as realizable. However, practice varies with respect to the carrying basis for current assets such as inventories. The basis for carrying inventories is stated in chapter 4. It is important that the amounts at which current assets are stated be supplemented by information which reveals, for the various classifications of inventory items, the basis upon which their amounts are stated and, where

practicable, indication of the method of determining the cost - e.g., *average cost, first-in first-out, last-in first-out*, etc.

10. Unearned discounts (other than cash or quantity discounts and the like), finance charges and interest included in the face amount of receivables should be shown as a deduction from the related receivables.

One member of the committee, Mr. Mason, assented with qualification to adoption of section A of chapter 3.

Mr. Mason does not accept the view implied in paragraph 6 that unamortized debt discount is an asset. Also, referring to paragraph 9, he believes that the market value is the most significant figure in connection with marketable securities held as temporary investments of cash, and would prefer to show such securities in the accounts at their market value, whether greater or less than cost. He would accept as an alternative the use of cost in the accounts with market value shown parenthetically in the balance sheet.

Section B —Offsetting Securities against Taxes Payable

1. It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists. Accordingly, the offset of cash or other assets against the tax liability or other amounts owing to governmental bodies is not acceptable except in the circumstances described in paragraph 3 below.

2. Most securities now issued by governments are not by their terms designed specifically for the payment of taxes and, accordingly, should not be deducted from taxes payable on the balance sheet.

3. The only exception to this general principle occurs when it is clear that a purchase of securities (acceptable for the payment of taxes) is in substance an advance payment of taxes that will be payable in the relatively near future, so that in the special circumstances the purchase is tantamount to the prepayment of taxes. This occurs at times, for example, as an accommodation to a local government and in some instances when governments issue securities that are specifically designated as being acceptable for the payment of taxes of those governments.

4-6. [These paragraphs have been deleted. See Status page.]

Chapter 4: Inventory Pricing

1. Whenever the operation of a business includes the ownership of a stock of goods, it is necessary for adequate financial accounting purposes that inventories be properly compiled periodically and recorded in the accounts.[1] Such inventories are required both for the statement of financial position and for the periodic measurement of income.

[1] Prudent reliance upon perpetual inventory records is not precluded.

2. This chapter sets forth the general principles applicable to the pricing of inventories of mercantile and manufacturing enterprises. Its conclusions are not directed to or necessarily applicable to noncommercial businesses or to regulated utilities.

Statement 1

The term *inventory* is used herein to designate the aggregate of those items of tangible personal property which (1) are held for sale in the ordinary course of business, (2) are in process of production for such sale, or (3) are to be currently consumed in the production of goods or services to be available for sale.

Discussion

3. The term *inventory* embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies). This definition of inventories excludes long-term assets subject to depreciation accounting, or goods which, when put into use, will be so classified. The fact that a depreciable asset is retired from regular use and held for sale does not indicate that the item should be classified as part of the inventory. Raw materials and supplies purchased for production may be used or consumed for the construction of long-term assets or other purposes not related to production, but the fact that inventory items representing a small portion of the total may not be absorbed ultimately in the production process does not require separate classification. By trade practice, operating materials and supplies of certain types of companies such as oil producers are usually treated as inventory.

Statement 2

A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues.

Discussion

4. An inventory has financial significance because revenues may be obtained from its sale, or from the sale of the goods or services in whose production it is used. Normally such revenues arise in a continuous repetitive process or cycle of operations by which goods are acquired and sold, and further goods are acquired for additional sales. In accounting for the goods in the inventory at any point of time, the major objective is the matching of appropriate costs against revenues in order that there may be a proper determination of the realized income. Thus, the inventory at any given date is the balance of costs applicable to goods on hand remaining after the matching of absorbed costs with concurrent revenues. This balance is appropriately carried to future periods provided it does not exceed an amount properly chargeable against the revenues expected to be obtained from ultimate disposition of the goods carried forward. In practice, this balance is determined by the process of pricing the articles comprised in the inventory.

Statement 3

The primary basis of accounting for inventories is cost, which has been defined generally as the price paid or consideration given to acquire an asset. As applied to inventories, cost means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location.

Discussion

5. Inventories are presumed to be stated at cost. The definition of cost as applied to inventories is understood to mean acquisition and production cost,[2] and its determination involves many considerations. Although principles for the determination of inventory costs may be easily stated, their application, particularly to such inventory items as work in process and finished goods, is difficult because of the variety of considerations in the allocation of costs and charges. For example, variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities. However, the allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity refers to a range of production levels. Normal capacity is the production expected to be achieved over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. Some variation in production levels from period to period is expected and establishes the range of normal capacity. The range of normal capacity will vary based on business- and industry-specific factors. Judgment is required to determine when a production level is abnormally low (that is, outside the range of expected variation in production). Examples of factors that might be anticipated to cause an abnormally low production level include significantly reduced demand, labor and materials shortages, and unplanned facility or equipment downtime. The actual level of production may be used if it approximates normal capacity. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of abnormally low production or idle plant.

> [2] In the case of goods which have been written down below cost at the close of a fiscal year, such reduced amount is to be considered the cost for subsequent accounting purposes. Paragraph 14 of APB Opinion No. 28, *Interim Financial Reporting,* provides guidance for preparing interim financial statements.

5A. Unallocated overheads are recognized as an expense in the period in which they are incurred. Other items such as abnormal freight, handling costs, and amounts of wasted materials (spoilage) require treatment as current period charges rather than as a portion of the inventory cost. Also, under most circumstances, general and administrative expenses[2a] should be included as period charges, except for the portion of such expenses that may be clearly related to production and thus constitute a part of inventory costs (product charges). Selling expenses constitute no part of inventory costs. The exclusion of all overheads from inventory costs does not constitute an accepted accounting procedure. The exercise of judgment in an individual situation involves a consideration of the adequacy of the procedures of the cost accounting system in use, the soundness of the principles thereof, and their consistent application.

> [2a] General and administrative expenses ordinarily should be charged to expense as incurred but may be accounted for as contract costs under the completed-contract method of accounting or, in some circumstances, as indirect contract costs by government contractors.

Statement 4

Cost for inventory purposes may be determined under any one of several assumptions as to the flow of cost factors (such as first-in first-out, average, and last-in first-out); the major objective in selecting a method should be to choose the one which, under the circumstances, most clearly reflects periodic income.

Discussion

6. The cost to be matched against revenue from a sale may not be the identified cost of the specific item which is sold, especially in cases in which similar goods are purchased at different times and at different prices. While in some lines of business specific lots are clearly identified from the time of purchase through the time of sale and are costed on this basis, ordinarily the identity of goods is lost between the time of acquisition and the time of sale. In any event, if the materials purchased in various lots are identical and interchangeable, the use of identified cost of the various lots may not produce the most useful financial statements. This fact has resulted in the development of general acceptance of several assumptions with respect to the flow of cost factors (such as *first-in first-out*, *average*, and *last-in first-out*) to provide practical bases for the measurement of periodic income.[3] In some situations a reversed mark-up procedure of inventory pricing, such as the retail inventory method, may be both practical and appropriate. The business operations in some cases may be such as to make it desirable to apply one of the acceptable methods of determining cost to one portion of the inventory or components thereof and another of the acceptable methods to other portions of the inventory.

> [3] Standard costs are acceptable if adjusted at reasonable intervals to reflect current conditions so that at the balance-sheet date standard costs reasonably approximate costs computed under one of the recognized bases. In such cases descriptive language should be used which will express this relationship, as, for instance, "approximate costs determined on the first-in first-out basis," or, if it is desired to mention standard costs, "at first-out basis," or, if it is desired to mention standard costs, "at standard costs, approximating average costs."

7. Although selection of the method should be made on the basis of the individual circumstances, it is obvious that financial statements will be more useful if uniform methods of inventory pricing are adopted by all companies within a given industry.

Statement 5

> A departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as its cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical deterioration, obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly designated as *market*.

Discussion

8. Although the cost basis ordinarily achieves the objective of a proper matching of costs and revenues, under certain circumstances cost may not be the amount properly chargeable against the revenues of future periods. A departure from cost is required in these circumstances because cost is satisfactory only if the utility of the goods has not diminished since their acquisition; a loss of utility is to be reflected as a charge against the revenues of the period in which it occurs. Thus, in accounting for inventories, a loss should be recognized whenever the utility of goods is impaired by damage, deterioration, obsolescence, changes in price levels, or other causes. The measurement of such losses is accomplished by applying the rule of pricing inventories at *cost or market, whichever is lower*. (If inventory has been the hedged item in a fair value hedge, the inventory's "cost" basis used in the cost-or-market-whichever-is-lower accounting shall reflect the effect of the adjustments of its carrying

amount made pursuant to paragraph 22(b) of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.) This provides a practical means of measuring utility and thereby determining the amount of the loss to be recognized and accounted for in the current period.

Statement 6

As used in the phrase *lower of cost or market*,[4] the term *market* means current replacement cost (by purchase or by reproduction, as the case may be) except that:

[4] The terms *cost or market, whichever is lower* and *lower of cost or market* are used synonymously in general practice and in this chapter. The committee does not express any preference for either of the two alternatives.

(1) Market should not exceed the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal); and

(2) Market should not be less than net realizable value reduced by an allowance for an approximately normal profit margin.

Discussion

9. The rule of *cost or market, whichever is lower* is intended to provide a means of measuring the residual usefulness of an inventory expenditure. The term market is therefore to be interpreted as indicating utility on the inventory date and may be thought of in terms of the equivalent expenditure which would have to be made in the ordinary course at that date to procure corresponding utility. As a general guide, utility is indicated primarily by the current cost of replacement of the goods as they would be obtained by purchase or reproduction. In applying the rule, however, judgment must always be exercised and no loss should be recognized unless the evidence indicates clearly that a loss has been sustained. There are therefore exceptions to such a standard. Replacement or reproduction prices would not be appropriate as a measure of utility when the estimated sales value, reduced by the costs of completion and disposal, is lower, in which case the realizable value so determined more appropriately measures utility. Furthermore, where the evidence indicates that cost will be recovered with an approximately normal profit upon sale in the ordinary course of business, no loss should be recognized even though replacement or reproduction costs are lower. This might be true, for example, in the case of production under firm sales contracts at fixed prices, or when a reasonable volume of future orders is assured at stable selling prices.

10. Because of the many variations of circumstances encountered in inventory pricing, Statement 6 is intended as a guide rather than a literal rule. It should be applied realistically in the light of the objectives expressed in this chapter and with due regard to the form, content, and composition of the inventory. The committee considers, for example, that the retail inventory method, if adequate markdowns are currently taken, accomplishes the objectives described herein. It also recognizes that, if a business is expected to lose money for a sustained period, the inventory should not be written down to offset a loss inherent in the subsequent operations.

Statement 7

Depending on the character and composition of the inventory, the rule of *cost or market,*

whichever is lower may properly be applied either directly to each item or to the total of the inventory (or, in some cases, to the total of the components of each major category). The method should be that which most clearly reflects periodic income.

Discussion

11. The purpose of reducing inventory to *market* is to reflect fairly the income of the period. The most common practice is to apply the *lower of cost or market* rule separately to each item of the inventory. However, if there is only one end-product category the cost utility of the total stock—the inventory in its entirety—may have the greatest significance for accounting purposes. Accordingly, the reduction of individual items to *market* may not always lead to the most useful result if the utility of the total inventory to the business is not below its cost. This might be the case if selling prices are not affected by temporary or small fluctuations in current costs of purchase or manufacture. Similarly, where more than one major product or operational category exists, the application of the *cost or market, whichever is lower* rule to the total of the items included in such major categories may result in the most useful determination of income.

12. When no loss of income is expected to take place as a result of a reduction of cost prices of certain goods because others forming components of the same general categories of finished products have a market equally in excess of cost, such components need not be adjusted to market to the extent that they are in balanced quantities. Thus, in such cases, the rule of *cost or market, whichever is lower* may be applied directly to the totals of the entire inventory, rather than to the individual inventory items, if they enter into the same category of finished product and if they are in balanced quantities, provided the procedure is applied consistently from year to year.

13. To the extent, however, that the stocks of particular materials or components are excessive in relation to others, the more widely recognized procedure of applying the *lower of cost or market* to the individual items constituting the excess should be followed. This would also apply in cases in which the items enter into the production of unrelated products or products having a material variation in the rate of turnover. Unless an effective method of classifying categories is practicable, the rule should be applied to each item in the inventory.

14. When substantial and unusual losses result from the application of this rule it will frequently be desirable to disclose the amount of the loss in the income statement as a charge separately identified from the consumed inventory costs described as *cost of goods sold*.

Statement 8

The basis of stating inventories must be consistently applied and should be disclosed in the financial statements; whenever a significant change is made therein, there should be disclosure of the nature of the change and, if material, the effect on income.

Discussion

15. While the basis of stating inventories does not affect the over-all gain or loss on the ultimate disposition of inventory items, any inconsistency in the selection or employment of a basis may improperly affect the periodic amounts of income or loss. Because of the common use and importance of periodic statements, a procedure adopted for the treatment of inventory items should be consistently applied in order that the results reported may be fairly allocated as between years. A change of such basis may have an important effect upon the interpretation of the financial statements both before and

after that change, and hence, in the event of a change, a full disclosure of its nature and of its effect, if material, upon income should be made.

Statement 9

> Only in exceptional cases may inventories properly be stated above cost. For example, precious metals having a fixed monetary value with no substantial cost of marketing may be stated at such monetary value; any other exceptions must be justifiable by inability to determine appropriate approximate costs, immediate marketability at quoted market price, and the characteristic of unit interchangeability. Where goods are stated above cost this fact should be fully disclosed.

Discussion

16. It is generally recognized that income accrues only at the time of sale, and that gains may not be anticipated by reflecting assets at their current sales prices. For certain articles, however, exceptions are permissible. Inventories of gold and silver, when there is an effective government- controlled market at a fixed monetary value, are ordinarily reflected at selling prices. A similar treatment is not uncommon for inventories representing agricultural, mineral, and other products, units of which are interchangeable and have an immediate marketability at quoted prices and for which appropriate costs may be difficult to obtain. Where such inventories are stated at sales prices, they should of course be reduced by expenditures to be incurred in disposal, and the use of such basis should be fully disclosed in the financial statements.

Statement 10

> Accrued net losses on firm purchase commitments for goods for inventory, measured in the same way as are inventory losses, should, if material, be recognized in the accounts and the amounts thereof separately disclosed in the income statement.

Discussion

17. The recognition in a current period of losses arising from the decline in the utility of cost expenditures is equally applicable to similar losses which are expected to arise from firm, uncancelable, and unhedged commitments for the future purchase of inventory items. The net loss on such commitments should be measured in the same way as are inventory losses and, if material, should be recognized in the accounts and separately disclosed in the income statement. The utility of such commitments is not impaired, and hence there is no loss, when the amounts to be realized from the disposition of the future inventory items are adequately protected by firm sales contracts or when there are other circumstances which reasonably assure continuing sales without price decline.

One member of the committee, Mr. Wellington, assented with qualification, and two members, Messrs. Mason and Peloubet, dissented to adoption of chapter 4.

Mr. Wellington objects to footnote (2) to statement 3. He believes that an exception should be made for goods costed on the *last-in first-out* (LIFO) basis. In the case of goods costed on all bases other than LIFO the reduced amount (market below cost) is cleared from the accounts through the regular accounting entries of the subsequent period, and if the market price rises to or above the original cost there will be an increased profit in the subsequent period. Accounts kept under the LIFO method should also show a similar increased profit in the subsequent period, which will be shown if the LIFO inventory is restored to its original cost. To do otherwise, as required by footnote (2), is to carry the

LIFO inventory, not at the lower of cost or current market, but at the lowest market ever known since the LIFO method was adopted by the company.

Mr. Mason dissents from this chapter because of its acceptance of the inconsistencies inherent in *cost or market whichever is lower*. In his opinion a drop in selling price below cost is no more of a realized loss than a rise above cost is a realized gain under a consistent criterion of realization.

Mr. Peloubet believes it is ordinarily preferable to carry inventory at not less than recoverable cost, and particularly in the case of manufactured or partially manufactured goods which can be sold only in finished form. He recognizes that application of the *cost or market* valuation basis necessitates the shifting of income from one period to another, but objects to unnecessarily accentuating this shift by the use, even limited as it is in this chapter, of reproduction or replacement cost as market when such cost is less than net selling price.

Chapter 5: Intangible Assets

[Chapter 5 has been deleted. See Status page.]

Chapter 6: Contingency Reserves

[Chapter 6 has been deleted. See Status page.]

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